COLUMBIA LAW REVIEW.

Published monthly during the Academic Year by Columbia Law Students.

SUBSCRIPTION PRICE, $2.50 PER ANNUM | 35 CENTS PER NUMBER

FEBRUARY, NINETEEN HUNDRED AND THIRTEEN.

NOTES.

THE ENTITY THEORY OF PARTNERSHIP UNDER THE NATIONAL BANKRUPTCY ACT.—That the Bankruptcy Act of 1898 contemplates a partnership as an entity separate and distinct from its members,[1] although regarded at first as an alarming novelty,[2] is now generally recognized.[3] Moreover, § 5-*h*, which provides that "in the event of one or more but not all of the members of a partnership being adjudged bankrupt, the partnership property shall not be administered in bankruptcy, unless by the consent of the partner or partners not adjudged bankrupt," is

[1] "Persons shall include corporations, except where otherwise specified, and officers, partnerships, and women." Bankruptcy Act, § 1 (19). "A partnership * * * may be adjudged a bankrupt." § 5-*h*.

[2] See Bank *v.* Meyer (1899) 92 Fed. 896; *In re* Forbes (1904) 128 Fed. 137; 8 COLUMBIA LAW REVIEW 599.

[3] *In re* Meyer (1899) 98 Fed. 976; 20 Harv. L. Rev. 589; Loveland, Bankruptcy, (4th ed.) § 255; *cf.* 8 COLUMBIA LAW REVIEW 391.

not considered inconsistent with the entity theory.[4] As the partner who is not bankrupt is the person most competent to administer firm funds,[5] the purpose of § 5-*h* seems to be merely to clothe him with the functions of a trustee in bankruptcy, and not to prevent the adjudication of the firm.[6]

It follows that a partnership may be adjudged bankrupt without the concomitant adjudication of all or any of its members,[7] and conversely, a partner may be declared bankrupt irrespective of an adjudication against the firm.[8] But the courts have reached inconsistent results in the application of the rule that a firm is an entity. The statute divides acts of bankruptcy into those which involve insolvency and those which do not.[9] When a partnership commits an act of the latter class, there is no difficulty in adjudicating the firm bankrupt apart from its members.[10] Confusion arises, however, when proceedings against the partnership are predicated on an act which involves insolvency, and one or more of the partners remain solvent, or for some reason cannot be adjudged bankrupt. In such cases some courts, although declaring that a partnership is a separate entity, refuse to adjudicate the firm apart from its members.[11] While it is true that a partner is liable *in solido* for firm debts, it by no means follows, as is argued by these tribunals, that a partnership must be solvent if the individual estate of one partner, over and above his personal debts, suffices to meet all liabilities of the firm.[12] The assets and liabilities of a partnership are distinct from the individual estates and debts of the several partners,[13] and since the firm is a "person,"[14] it would seem to be insolvent when firm assets fail to meet firm liabilities.[15] This result, which is that reached

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[4]See *In re* Bertenshaw (1907) 157 Fed. 363; Francis *v.* McNeal (1911) 186 Fed. 481; but see *In re* Forbes *supra.*

[5]See *In re* Bertenshaw *supra.*

[6]This conclusion is fortified by the further provision of § 5-*h*: "such partner or partners not adjudged bankrupt shall settle the partnership business as expeditiously as its nature will permit, and account for the interest of the partner or partners adjudged bankrupt." Another view reconciles § 5-*h* with § 1 (19) and § 5-*a* on the ground that § 5-*h* applies only when the firm is not adjudged bankrupt. See Francis *v.* McNeal *supra.*

[7]Bank *v.* Meyer *supra; In re* Meyer *supra;* but see *In re* Forbes *supra; In re* Blair (1900) 99 Fed. 76.

[8]Mills *v.* Fisher (1908) 159 Fed. 897.

[9]Bankruptcy Act, § 3-*a;* West Co. *v.* Lea (1899) 174 U. S. 590.

[10]*In re* Meyer *supra.* The commission of an act of bankruptcy by one partner, which operates to throw the firm into bankruptcy, will also authorize the adjudication of that partner. Bank *v.* Meyer *supra.* On the other hand, an act of bankruptcy which only affects the partner individually, will not render the partnership liable to bankruptcy proceedings. *In re* Mercur (1902) 116 Fed. 655; aff'd (1903) 122 Fed. 384.

[11]Vaccaro *v.* Bank (1900) 103 Fed. 436; Davis *v.* Stevens (1900) 104 Fed. 235; *In re* Boyd (1908) 20 Am. B. R. 330.

[12]*In re* McMurtrey (1905) 15 Am. B. R. 427.

[13]*In re* Bertenshaw *supra.*

[14]See note 1 *supra.*

[15]"A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, * * * shall not, at a fair valuation, be sufficient in amount to pay his debts." Bankruptcy Act, § 1 (15).

in a majority of jurisdictions,[16] follows the entity theory to its logical conclusion; and since a discharge of the partnership in bankruptcy leaves its members still liable *in solido* for firm debts,[17] it imposes no hardship on firm creditors.

The reluctance of some courts to extend the application of the partnership entity theory to its logical limits is further illustrated by the recent case of *In re R. F. Duke & Son* (N. D. Ga. 1912) 199 Fed. 199. A partner in a bankrupt firm, who was principally engaged in farming, and therefore could not himself be adjudged bankrupt,[18] was ordered to surrender his individual property to the firm's trustee that the latter might administer this property together with that of the firm. The partnership was recognized as an entity for purposes of adjudication, but since the assets of the individual members were held to be properly subject to administration in proceedings against the firm, the practical effect of this recognition was nullified. The weight of authority supports this conclusion,[19] some cases holding that the liability of the individual partners for firm debts is a firm asset.[20] This is, of course, inconsistent with the view that a firm may be insolvent though the individual partners are solvent, and it would seem that the true nature of the partner's liability is rather that of an indebtedness due directly to creditors of the firm.[21] The result of the principal case is probably based on a lingering idea that a partnership should not be treated as an entity,[22] because it is thought that an effective liquidation of the partnership business requires that the amount of individual property which may be used to satisfy firm debts should be determined in the proceedings against the firm.[23] As firm creditors can realize on such property in any case,[24] and as a discharge of the firm has no effect on this right,[25] the necessity for thus drawing a partner's individual property into the administration of firm assets is doubtful. The convenience of settling in one proceeding the rights of firm creditors against both the partnership and its members, furnishes the only possible justification for the view of the principal case, while, on the other hand, this view results in imposing the burdens of bankruptcy upon one who is exempted by the statute, and who, therefore, cannot obtain the benefits of the proceeding. Full recognition of a partnership as

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[16]*In re* McMurtrey *supra; In re* Bertenshaw *supra; In re* Everybody's Market (1908) 173 Fed. 492.

[17]*In re* Hale (1901) 107 Fed. 432; see *In re* Bertenshaw *supra.*

[18]"Any natural person, except a wage-earner or a person engaged chiefly in farming or the tillage of the soil, * * * may be adjudged an involuntary bankrupt upon default or an impartial trial, and shall be subject to the provisions and entitled to the benefits of this Act." Bankruptcy Act, § 4-*b*.

[19]Matter of Wing Yick Co. (1905) 13 Am. B. R. 757; *In re* Junck (1909) 169 Fed. 481; *In re* Lattimer (1909) 174 Fed. 824; *In re* Perlhefter (1910) 177 Fed. 299; Dickas *v.* Barnes (1905) 140 Fed. 849; Francis *v.* McNeal *supra; contra, In re* Bertenshaw *supra.*

[20]Dickas *v.* Barnes *supra.*

[21]§ 5-*f* applies the surplus of a partner's property remaining after payment of his individual debts to payment of the partnership debts.

[22]See *In re* Forbes *supra.*

[23]Dickas *v.* Barnes *supra; In re* Stokes (1901) 106 Fed. 312.

[24]*In re* Bates (1900) 100 Fed. 263.

[25]*In re* Hale *supra.*

an entity for purposes both of adjudication and of administration would seem to be the logical rule under the Bankruptcy Act, but few courts have granted such an unqualified sanction to the entity theory.

RIGHT TO PRE-EMPTION IN AN ISSUE OF CAPITAL STOCK.—The right of a shareholder in a corporation to subscribe at par[1] to his proportionate share in any new issue of stock,[2] whether authorized at the time of the issue,[3] or at the inception of the corporation,[4] is well settled. The theoretical basis of this doctrine of pre-emption is that the ownership of stock confers upon the stockholder an equitable interest in both the profits and the management of the business; and that any distribution of stock which is not proportional would give the recipient at par of more than his *pro rata* share a greater interest in surplus profits and a more potent voice in corporate meetings than he is equitably entitled to.[5] The directors are looked upon as holding the new stock in trust for the stockholder,[6] and consequently, even though a statute authorizes the directors to make new issues in such manner as they see fit, they are held, in the execution of their fiduciary function, to an equitable *pro rata* distribution.[7] It is clear, therefore, that the Indiana view, that such a statute enables the directors to place strangers on an equal footing with stockholders,[8] cannot be reconciled with the otherwise universal acceptance of the doctrine of pre-emption.[9]

The practical consideration which first gave rise to this doctrine, was the necessity of restraining directors from depriving stockholders of their share of surplus profits by issuing to others at par new stock

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[1]Hammond *v.* Edison Co. (1902) 131 Mich. 79; Cunningham's Appeal (1885) 108 Pa. 546. But if a bonus has been paid it cannot be recovered. De la Cuesta *v.* Ins. Co. (1890) 136 Pa. 62.

[2]The original case establishing the doctrine of pre-emption is Gray *v.* Portland Bank (1807) 3 Mass. 364. It seems to go on the theory that there is a contract between stockholders that each shall share in an increase of capital stock.

[3]Stokes *v.* Continental Trust Co. (1906) 186 N. Y. 285; Wall *v.* Copper Co. (1905) 70 N. J. Eq. 17.

[4]Snelling *v.* Richards (1909) 166 Fed. 635; Gray *v.* Portland Bank *supra.* There is no right of pre-emption in the original issue of stock, however, until the stock-books have once been closed. 1 Machen, Corporations, § 618.

[5]Stokes *v.* Trust Co. *supra;* Wall *v.* Copper Co. *supra.* The doctrine of pre-emption is held to apply neither to cases where new stock is issued for new property, Meredith *v.* Zinc & Iron Co. (1897) 55 N. J. Eq. 211, nor to those where the issue is made in the process of consolidation. Bonnett *v.* Nat. Bank (1900) 24 Tex. Civ. App. 613. In both of these classes of cases, the argument arising from a right in the division of profits evidently does not apply; but it is submitted that the old stockholders' voice in corporate management is diminished. The result is just, however, as the stockholders are usually well compensated for their loss.

[6]Schmidt *v.* Pritchard (1907) 135 Ia. 240; Strickler *v.* McElroy (1911) 45 Pa. Sup. Ct. 165; Bennett *v.* Baum (1911) 90 Neb. 320.

[7]Luther *v.* Luther Co. (1903) 118 Wis. 112.

[8]Ins. Co. *v.* Nunnemacher (1860) 15 Ind. 294.

[9]England as well as America adheres to the doctrine of pre-emption. Punt *v.* Symons Co., L. R. [1903] 2 Ch. 506.